IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1958

No. 50

F. STRAUSS & SON, INC., OF ARKANSAS
Petitioner

vs.

COMMISSIONER OF INTERNAL REVENUE
Respondent

On Writ of Certiorari to the
United States Court of Appeals
for the Eighth Circuit

REPLY BRIEF FOR PETITIONER

E. Chas. Eichenbaum
1211 Boyle Bldg.
Little Rock, Arkansas
Attorney for Petitioner

Leonard L. Scott
W. S. Miller, Jr.
1211 Boyle Bldg.
Little Rock, Arkansas
Of Counsel

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It is not the purpose of this Reply Brief to try to answer each and every facet of the Government's argument, for many of these contentions, we believe, will fall of their own weight. Indeed, it is not so much what the Government has said, as what it has failed to say, that we think should be called to this Court's attention, as additional evidence of the strength of our original position.

I

Apart From the Regulation, the Expenses Were Unquestionably Ordinary and Necessary

It is significant that nowhere in its brief has Respondent denied our most fundamental assertion:—name-

ly, that apart from the regulation, the expenses of preserving a business from destruction were clearly ordinary and necessary. We do not here reiterate the argument shown at pages 9-13 of our main brief; but we do want to call to this Court's attention as strongly as we can, again and again, that the expenses were clearly allowable had there been no regulation. The Respondent should not be permitted by oblique attacks and the raising of side issues to obscure that basic consideration in this case. It, of course, goes without saying, that a regulation attempting to deny a deduction clearly allowable under the statutes, is, to that extent, invalid. *Bingham Trust Company* v. *Comm.*, 325 U.S. 365, 89 L. Ed. 1670; *Campbell Galeno Chemical Co.*, 281 U.S. 599, 74 L. Ed. 1063; *Miller* v. *U. S.*, 294 U.S. 435, 440, 79 L. Ed. 977; *Koshland* v. *Helvering*, 298 U.S. 446, 447, 80 L. Ed. 1268.

II

The Regulation, as Applied to this Case, is Bolstered Neither by Textile Mills nor the Re-Enactment Rule

(A) *Textile Mills is Limited to Expenses of Doubtful Legality*

Although this Court, in *Comm.* v. *Heininger*, 320 U.S. 467, at page 473, and *Lilly* v. *Comm.*, 343 U.S. 90, 95, referred to Textile Mills as involving some types of lobbying long condemned by it, although the Tax Court in its opinion below (R.32) distinguished Heininger and Lilly from Textile Mills on the ground that they did not involve "expenditures used for lobbying purposes", and although the language in the Textile Mills case seems to indicate that this Court itself regarded lobbying as involved, we may here assume, for the purpose of argument, that there existed in Textile Mills no lobbying in the strict sense. This is far from saying, however, that the possibility of lobbying and political pressure had nothing

to do with the case. Indeed, as we have indicated in our brief in main, it was the *tendency* of the very contract involved to cause the forbidden individual and personal influence and solicitation that was a principal cause of its illegality. The contract was void regardless of whether corruption was actually resorted to; its evil tendency was sufficient to vitiate it. *Hazelton* v. *Sheckells*, 202 U.S. 71, 79, 26 S. Ct. 567, 568, 50 L. Ed. 939, 6 Ann. Cas. 217; *Powers* v. *Skinner*, 32 Vt. 274, 80 Am. Dec. 677; *Marshall* v. *Baltimore & Ohio Railroad* (1853), 16 Haw. (U.S.) 314, 14 L. Ed. 953; 29 ALR 159, et seq.; see also 46 ALR 196. Some courts, including this Court (*Providence Tool Company* v. *Norris* (1865), 2 Wall. (U.S.) 45, 17 L. Ed. 868; *Crocker* v. *U. S.* (1916), 240 U.S. 74, 60 L. Ed. 533, 36 Sup. Ct. Rep. 245; *Trist* v. *Child* (1874), 21 Wall. 441, 22 L. Ed. 623), have placed a stronger emphasis on the contingency aspect of contracts to procure concessions, favors or legislation from the government or officials thereof than others, who do not consider that aspect alone fatal. 46 ALR 203, 29 ALR 166. Again, it is the tendency to cause corrupt action rather than existence or non-existence thereof that is emphasized.

But, as we tried to urge in our brief in main, it was not the actual but the probable illegality of the contract that was important. We are amazed to see Respondent even suggest (B.23) that this court had said in Textile Mills that whether the contract was contrary to public policy was "not material". We are reminded of an old sentence derived from childhood, which read: "Johnny said the teacher was a fool." Properly punctuated and emphasized, the sentence read: "Johnny," said the teacher, "is a fool." Similarly, when this Court said "whether the precise arrangement here in question would violate the rule of those cases is not material", it was not emphasizing the phrase, "not material"; it was em-

phasizing "the precise arrangement". And for Respondent to further say (B.23) that even if the contract was contrary to public policy, that such a conclusion is "without relevance" is to ignore not only this Court's own statement in Textile Mills, that there was no reason why the rule-making authority could not draw a line between legitimate business expenses and ". . . those arising from the family of contracts to which the law has given no sanction . . .", but to further ignore the fact that such is the very distinction recently drawn by this Court in *Tank Truck Rentals, Inc.* v. *Comm.*, 356 U.S. 30, 2 L. Ed. (2d) 562, 78 S. Ct. 507 (1958), where this Court characterized Textile Mills as upholding "the validity of an income tax regulation reflecting an administrative distinction 'between legitimate business expenses and *those arising from that family of contracts to which the law has given no sanction*' " (emphasis furnished). And Respondent's argument as to why such conclusion is "without relevance" is even more interesting. He asserts, citing Heininger, that *mere illegality* is insufficient to disallow a deduction—with which we agree. But the entire basis of Respondent's argument in this case, reduced to its simplest form, is that the deduction in this case was properly disallowed *although completely legal*, merely because of the regulation (B.24).

(B) *The Re-Enactment Rule is Inapplicable*

It is also significant that the Respondent has nowhere answered our argument set forth in pages 24 through 32 of our brief in main. If he takes issue with our conclusion that in 1939 and immediately prior to Textile Mills the re-enactment rule, if anything, would sustain Petitioner's position, we are unable to find such an assertion on his part, and certainly he cites no cases that would lead to a contrary conclusion. What Respondent does is merely ignore our argument,

blithely asserting without foundation that the decisions are "numerous and authoritative" (p.26). But let us see what cases he does cite. *Old Mission Cement Company* v. *Comm.*, 69 Fed. (2d) 676, Aff'd. 293 U.S. 289, was decided in 1936, and it is distinguishable on two separate grounds. First, the expenses—expenses of approving a referendum for an increased gasoline tax levy to provide additional funds for road building—were considered to be too remotely related to the concrete business of taxpayer; and, secondly, the expense was itself admittedly characterized as involving "lobbying". *Sunset Scavenger Co.* v. *Comm.*, 84 Fed. (2d) 453, was decided in 1936, and even assuming it was otherwise in point, as we have pointed out in our main brief (p.28), it simply was not in accord with the majority rule at that time. *Revere Racing Ass'n* v. *Scanlon* (1956), 232 Fed. (2d) 816; *Davis* v. *Comm.* (1956), 26 T.C. 49; *Wm. T. Stover Co.* v. *Comm.* (1956), 27 T.C. 434, and *Mosby Hotel Co.* v. *Comm.* (Oct., 1954), 1957 T.C. Memo, para. 54288, were all decided not only after the year here involved, 1950, but even after the enactment of the 1954 Code. *Roberts Dairy Co.* v. *Comm.*, 195 Fed. (2d) 948, C.A. 8th (1952), decided after the year here involved, held the expenses involved were not deductible *as a donation under Section 23(q)-2.* Textile Mills was not relied on or even cited. *McClintock-Trunkey Co.* v. *Comm.*, 19 T.C. 297, and *American Hardware & Eq. Co.* v. *Comm.*, 202 Fed. (2d) 126, decided respectively in 1952 and 1953, like Roberts Dairy, were not only decided after the year involved, but such a short period prior to 1954 that, even assuming that legislation in 1954* could otherwise properly be deemed re-enactment with respect to 1950, the interpretation given by those

*Statutes, of course, must be prospectively applied unless the contrary intent is clear. **Hassett v. Welch, 303 U.S. 303, 82 L. Ed. 858 (1938); Brewster v. Gage, 280 U.S. 327, 74 L. Ed. 457.** Assuming re-enactment gives a regulation the "effect" of law, shall the already much criticized doctrine be extended to give it such effect retroactively?

courts could hardly be regarded at that time as being "well settled" or "long continued".

This must be particularly true in view of the fact that since 1944 Congress had before it the decision of the Tax Court in *Luther Ely Smith*,** 3 T.C. 696 (1944), acquiesced in by the Commissioner, that the regulation did not apply to a constitutional amendment to be voted upon by the people, because such initiated action was not "legislation". It is difficult to see how Congress could have thought other initiated acts were in a different category.

Further, what effect did Heininger and Lilly have on Textile Mills? Was this "well settled" in 1954, particularly when this Court had not yet spoken?

In somewhat the same connection, how could Congress "reenact" a version of the Regulation different from that warranted by the exact holding of Textile Mills?

We have asserted that the thrust of Textile Mills —if it can be reconciled with Heininger—was limited to expenses illegal or against public policy. If that decision extends to all expenses of every kind of legitimate activity affecting i n f l u e n c i n g l e g i s lation of every kind, then there is an end to the matter. But if our assertion is correct, can it be said that Congress, by some mumbo-jumbo mixture of silent acquiescence and retroactive action has "re-enacted" a different meaning, and has thereby in some strange way removed from this Court the power to interpret its own decision?

Mosby Hotel, **infra, decided October, 1954, relied on by Respondent (Footnote 19, Br. 44), as "vitiating" the "validity" of Luther Ely Smith, **infra**, did not even cite the Smith case. Further, we are talking about re-enactment. How Congress, even if it could affect 1950 by a 1954 enactment, could "re-enact" a case not even then decided, is hard to understand.

(c) *The Activities, Albeit Characterize as Propaganda, Are Still Legal and Proper*

The suggestion by the Government that what is involved here in any event is "propaganda" that stands on a different footing is without foundation. It would be strange if that which by hypothesis is legal and deductible, the Regulation prohibiting lobbying and expenses of influencing legislation to the contrary notwithstanding, becomes illegal and non-deductible when characterized as propaganda, particularly when the latter term may well have been inserted merely to list one of the methods of carrying out the preceding ones.

In any event, propaganda, as pointed out by Judge Learned Hand in the *Slee* case cited by Respondent (*Slee* v. *Comm.*, 42 Fed .(2d) 184), is merely a "polemical word used to decry the publicity of the other side". See also page 7 of the Amicus brief—is this "propaganda" or education? And it is not to be forgotten that Judge Simon in his opinion in *Seasongood* v. *Comm.*, 227 Fed. (2d) 907, cited by Respondent, recalled that propaganda has been characterized as the "technique of the 'Big Lie' ", and that in his view the term, under the statute, connoted ". . . coloring or distortion of facts". No such coloring or distortion of facts appears in this record (R.14-16; joint exhibits 7-G and 9-I, No. 50). There is nothing in this record giving any indication of falsity or deception in any of the statements addressed to the electorate.

The test to be applied to this portion of the regulation if otherwise applicable is the same as applied by Textile Mills to that portion relating to expenses of lobbying or of influencing legislation. If the expenses are illegal or against public policy, then we assume, *arguendo* (cf. p. 7 of this brief and footnote thereto), the regula-

tion prohibiting deduction of such expenses is to that extent valid; if the expenses are not illegal or against public policy (or probably so), the regulation is invalid.

Tested by such rules, it is apparent that there is nothing illegal or probably illegal, even if these expenses should be characterized as "propaganda". Although there is no specific finding as such in No. 50, the District Court in No. 29 specifically found (R.29,47) that there was nothing corrupt about spending money for these purposes; that, to the contrary, it was a perfectly proper and laudable activity. The expenditures in No. 50 were certainly just as proper and laudable. As we have indicated, all factual assertions appear to be true and all arguments fairly made. No deception or discoloration is apparent, or suggested the Tax Court (R.30) specifically found that the advertising contained "reasons and statistics" (not, misrepresentations and false figures) "designed to convince the voters it was in the public interest to defeat the Act". The argument (B.52) that the interest of the liquor wholesalers remained "untraceable" is ridiculous in view of advertisements that six million dollars in revenue from taxes on alcoholic beverages would be lost, that the "brewing industry" was the Arkansas rice farmers' best customer (Ex. H-8, R.-15); that the "brewing industry" bought over three million dollars of rice annually, and that 12,000 jobs would be lost (Ex. 9-I, R.-16,23). Any argument of anonymity is scarcely borne out in light of the fact that some advertisements gave the names of hundreds of citizens supporting it (Joint Ex. H-8, R. 15, Joint Ex. 9-I, R.23 No. 50) and there is no indication that the advertisements involved were not also sponsored by others than petitioner's group. It is to be doubted that the public, in any event, ever felt that arguments against return of prohibition were exactly opposed by those in the liquor business in Arkansas.

We pause to turn to the contract in the Textile Mills case as a factor for comparison. There the evil tendency of the contract invalidated it and contaminated expenses thereunder. Here, even if there had been a contract with an independent agency to devise advertising to d e f e a t the act, we nol it would h a v e been illegal. The underlying basis for i n v a l i d a t i n g typical contracts to procure legislation, the tendency to cause the corrupting elements of personal influence and solicitation, would be necessarily absent from such a contract. In any event, there was no contract here, and the expenditures made were perfectly legal.

We must not forget the existence of *Comm.* v. *Heininger, supra,* and *Tank Truck Rentals, Inc.* v. *Comm.,* 356 U.S. 30, 2 L. Ed. (2d) 562, 78 S. Ct. 507 (1958). These cases make it clear that the frown of public policy is insufficient to deny deduction of expenses otherwise deductible. The allowance of the deductions must frustrate sharply defined national and state policies, which must be evidenced by some governmental declaration thereof. Both conditions must exist; the expenses must frustrate public policy, and there must be a governmental declaration thereof. At best,* t h e r e g u l a t i o n in this case expresses the governmental declaration. The law as settled by this Court in T r u c k Tank Rentals and in Textile Mills itself, at least limits the application of that regulation to expenses against or at least probably against public policy. To the extent the regulation draws a line in an area of doubtful legality (although it is difficult to reconcile mere illegality as a basis

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*We do not in any manner wish to be considered as conceding that the Commissioner, by regulation, can establish a "public policy", and then later pull himself up by his bootstraps and point to the regulation as the requisite "governmental declaration thereof". See pages 5 and 13 of the Amicus brief filed in this cause. The instant case would point up the required denial of such a rule, for the "policy" thereby established might go far beyond the sphere of illegality.

for disallowance of the deduction with Heininger), we assume at this point that such regulation is valid. "The general policy being clear, it is not for this Court to draw the line."

But at least the "general policy" must also be there. Certainly, not even the Respondent, we think, would contend that the regulation would be valid if, instead of reading as it did, it read "including trade advertising and all other types of advertising". And it should be remembered, in the same connection, that in a sense most trade advertising can be regarded as "propaganda". Is it thereby not to be allowed as a deduction? Assuming there is a power at all for the Commissioner to fix public policy, there must be a limit to which a regulation can represent a governmental declaration of public policy. We do not here attempt to define those limits. Certainly many questions of law are questions of degree. The bad fades into the good so imperceptibly that it is understandable that there should be no attempt to draw a line in cases of doubt. Sustaining a regulation, however, where the expense involved is of doubtful legality is no basis whatsoever for sustaining the regulation where the expense involved, as is true in this case, is clearly legal and not against public policy; and this is particularly true in view of the pronouncements of Heininger, Lilly and Tank Truck Rentals, all *supra*.

III

References to Sections Governing Contributions Are Not Relevant

We are unable to perceive why it is "anomalous" (Respondent's B.31) to hold that an expense which is ordinary and necessary should not be allowed because the same expense is not allowable as a charitable contribution. If Congress intended to equate business expense with charita-

ble donations, there would be no need to have the separate sections at all.

Prior to 1936 corporations could take no deduction for charitable contributions unless such donations qualified as an ordinary and necessary business expense. However, beginning with the 1935 act, a corporation has been allowed deduction for charitable contributions, subject to a 5% limitation, and, since 1938, subject to a further limitation that no part of such contribution* in excess of the 5% limitation could be deducted as a business expense (Section 23(a)-1(B), IRC 1939). In cases of individuals, contributions have been permitted since 1917. It was not until the 1954 act that there was a limitation that no part of contributions by individuals in excess of the permissible limitations could be deducted as a business expense (Section 162(b), IRC, 1954) (for a resume of this history, see Merten's, Vol. 4, Chap. 25, p. 246). Both the 1939 Code and now the 1954 Code have specifically recognized that there are many contributions which happen to qualify also as business expenses — if such a simple proposition needs recognition. The pertinent provisions simply impose a limit on such deductions as business expenses. On the other hand, if the contribution is made to a non-qualifying organization, and otherwise qualifies as a business expense it may be deducted without limitation (Merten's, Vol. 5, Chap. 31, p. 41).

Congress has never said that if an expense is a business expense there is any limitation upon its deduction, except to say that if what is a business expense also qualifies as a charitable deduction, it is limited in deduction as a business expense by Sec. 23 (a)-1(B) (and

*If it is "in fact" a contribution, Sec. 29.23(a)-13, Reg. 111; cf. **McDonnell Aircraft Corp.**, 16 T.C. 189, 198. We do not need here engender unimportant controversy by considering to what extent situations may exist where business expenses are "in fact" contributions and subject to the limitation.

now, of course, by Sec. 162 (b) IRC (1954). *Wm. L. Stover Co.*, 27 T.C. 434, 442, and report of Committee on Ways and Means cited in footnote thereto.

The provisions prohibiting deduction as charitable contributions of donations to organizations substantially engaged in influencing legislation orginated with the 1934 and 1935 acts, as pointed out by Respondent (Br.28, p.29). But these provisions have never been considered expressly or impliedly as limiting in any way deductions under Sec. 23(a). The truth of the matter is that it should be apparent to even the most casual observer that when Congress limited deductions of donations to organizations, no substantial part of the activities of which is carrying on propaganda or influencing legislation, it did so merely because it did not regard organizations which carried on such propaganda or attempted to influence legislation as religious, charitable, scientific or educational. It had no idea of thereby preserving the "equilibrium" of the tax structure (Respondent's Br. p. 36).

If Congress wanted to limit the deductability of business expenses by the restrictive phraseology of Sections 23(q) and (o), why did it not add such restrictions to 23(a)(1)(A) itself? The pertinence of such an inquiry is emphasized by the fact that Congress did enact Sec. 23(a)-1(B) in the 1939 Code, and Sec. 162 in the 1954 Code,—but nothing more.

CONCLUSION

For the reasons given, it is submitted that the judgment below should be reversed.

Respectfully submitted,

E. CHAS. EICHENBAUM
1211 Boyle Bldg.
Little Rock, Arkansas
Attorney for Petitioner

LEONARD L. SCOTT
W. S. MILLER, JR.
1211 Boyle Bldg.
Little Rock, Arkansas
Of Counsel